

Message Text

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ORIGIN SS-30

INFO OCT-01 SSO-00 ISO-00 /031 R

DRAFTED BY E:JWBILLER:CB

APPROVED BY E:WJCASEY

S/S- WHLUERS

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TO AMEMBASSY ROME IMMEDIATE

C O N F I D E N T I A L STATE 010092

EXDIS

E.O. 11652: GDS

TAGS: EFIN, GW

SUBJECT: FRG OFFSET

FOR UNDER SECRETARY VOLCKER FROM UNDER SECRETARY CASEY

1. I HAVE JUST RECEIVED RESULTS OF STUDY I REQUESTED ON RATIONALE FOR INCLUSION OF FLOWBACK IN BILATERAL OFFSET AGREEMENT WITH FRG. MY CONCLUSION AFTER READING IT IS THAT ALTHOUGH CONSIDERABLE STATISTICAL WORK STILL MUST BE DONE, BASIS FOR ACCEPTING SIGNIFICANT FLOWBACK FIGURE, I.E., UP TO 20 PERCENT, IS CONSIDERABLY BETTER THAN I HAD THOUGHT. YOU MAY FIND FOLLOWING BRIEF RESUME OF STUDY USEFUL AS BACKGROUND IN CONNECTION WITH SCHULTZ-SCHMIDT CONVERSATION ON OFFSET.

2. RATIONALE FOR FEEDBACK IN CONTEXT OF OFFSET ARRANGEMENT IS BASED ON CHANGES IN LEVEL OF DOMESTIC DEMAND, RELATIVE PRICES AND FISCAL AND MONETARY POLICIES WHICH US MILITARY SPENDING INDUCES IN FRG. INCREASED FOREIGN EXCHANGE AVAILABILITY IN FRG AS RESULT OF US MILITARY EXPENDITURES IS REFLECTED IN HIGHER LEVEL OF GERMAN DEMAND FOR IMPORTS FROM ALL SOURCES.

TO EXTENT THAT SOURCE IS U.S., THERE IS DIRECT INCREASE IN U.S. EXPORTS. TO EXTENT THAT SOURCE IS OTHER COUNTRIES, CONFIDENTIAL

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THERE IS INDIRECT INCREASE IN U.S. EXPORTS, SINCE THOSE COUNTRIES IN TURN IMPORT MORE FROM U.S. WITH PART OF EARNINGS FROM INCREMENTAL SALES TO GERMANY.

3. METHODOLOGY PRESENTS SEVERAL DIFFICULT PROBLEMS. FOREGOING RATIONALE ASSUMES THAT ALL IMPORTS ARE MARKET DETERMINED, AND ADJUSTMENT WOULD HAVE TO BE MADE FOR MILITARY PROCUREMENT IMPORTS WHICH ARE FIXED BY GOVERNMENTAL AGREEMENT. IN ADDITION, IT WILL BE DIFFICULT TO OBTAIN RECENT DATA AND EVEN LATEST DATA AVAILABLE MAY NOT BE VALID TO PREDICT THE FUTURE IN VIEW OF THE CHANGES IN WORLD ECONOMIC CONDITIONS THAT ARE NOW OCCURRING. HOWEVER, MAGNITUDE OF FLOWBACK ON BASIS OF FOREGOING RATIONALE CAN BE APPROXIMATED FOR PAST YEARS BY ECONOMETRIC TECHNIQUES, AND RESPECTABLE CASE CAN BE MADE FOR SIGNIFICANT FLOWBACK EFFECT.

4. I WOULD APPRECIATE RECEIVING CABLE REPORT OF SCHULTZ-SCHMIDT CONVERSATION AS SOON AS POSSIBLE AFTER IT HAS TAKEN PLACE. RUSH

NOTE BY OCT: EXDIS CAPTION ADDED PER INSTRUCTIONS, S/S-O, MR. NEWLIN.

CONFIDENTIAL

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Message Attributes

Automatic Decaptioning: Z
Capture Date: 27 JUL 1999
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: REPORTS, AGREEMENTS, DATA, FINANCIAL DATA
Control Number: n/a
Copy: SINGLE
Draft Date: 16 JAN 1974
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: golinofr
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974STATE010092
Document Source: ADS
Document Unique ID: 00
Drafter: E:JWBILLER:CB
Enclosure: n/a
Executive Order: 11652 GDS
Errors: n/a
Film Number: P750004-1228
From: STATE
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740175/abbrzbtel
Line Count: 75
Locator: TEXT ON-LINE, TEXT ON MICROFILM
Office: ORIGIN SS
Original Classification: CONFIDENTIAL
Original Handling Restrictions: EXDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 2
Previous Channel Indicators:
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: EXDIS
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: golinofr
Review Comment: n/a
Review Content Flags:
Review Date: 21 MAY 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <21 MAY 2002 by boyleja>; APPROVED <18 DEC 2002 by golinofr>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: FRG OFFSET
TAGS: EFIN, US, GE
To: ROME
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005